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Supreme Court of the United States

October Term, 1969

No. 925

MORTON GLOBUS, BARBARA D'AMATO, JOHN JACOBOWSKI and BAZYL JACOBOWSKI (jointly), ALFRED OXENFELD, CONRAD TAFF, ROSE SLAYTON, JACK STEINFINK and STELLA STEINFINK (jointly), JACK STEINFINK, HAROLD ALENICK, CECILE GREENBERG and MURIEL PLOTKIN (jointly), BETTY SIMON, HARRY BALTERMAN and CHARLES SEMENETZ, JR.,
Petitioners,

against

LAW RESEARCH SERVICE, INC. and ELLIAS C. HOPPENFELD,
Respondents,

and

BLAIR & CO., GRANBERY MARACHE INCORPORATED,
Respondent and Third-Party Plaintiff,

against

PAUL WIENER,
Third-Party Defendant.

BRIEF OF RESPONDENT, ELLIAS C. HOPPENFELD, IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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Counter-Statement of Question Presented

Whether punitive damages are available as a remedy for a violation of §17 (a) of the Securities Act of 1933, 15 U. S. C. §77q(a).

Counter-Statement of Facts

The plaintiffs, all former purchasers of stock in Law Research Service, Inc., brought this action against Law Research Service, Inc.,* the issuer of the stock, Ellias C. Hoppenfeld, its president and director, and Blair & Co., Granbery, Marache, Inc.,** the underwriter of the public stock offering for common law fraud and for violations of Sections 17a and 10b of the 1933 and 1934 Federal Securities Acts and Rule 10-6-5 of the Securities and Exchange Commission on the grounds that said defendants allegedly issued an offering circular effective March 15, 1965, in which there were material omissions of fact which, had they been known to the plaintiffs, would have prevented them from purchasing the stock and on the further ground that each of said plaintiffs suffered a loss as the result of his or her purchases and sales of the stock.

The offering circular contained a statement that L.R.S. had entered into a five year contract with Sperry Rand, under which Sperry Rand was to provide various services in connection with L.R.S.'s computerized legal research service (Ex. 2). The offering circular also made it clear that L.R.S. stock was a highly speculative investment and that, at the time of the offering, L.R.S. was indebted to Sperry Rand in the amount of $82,285 for services rendered by Sperry Rand, which debt—or such portions of it as could not be deferred—would be paid from the proceeds of the public stock offering and with the aid of loans from two lending institutions (Ex. 2, 619a, 621a).

The alleged material omission was that the circular failed to state that a dispute had arisen between L.R.S. and Sperry Rand in the course of which Sperry Rand had

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* Hereinafter referred to as L.R.S.

** Hereinafter referred to as Blair & Company or Blair.

allegedly terminated the contract and refused to render further services and L.R.S. had commenced suit against Sperry Rand.

L.R.S. and Hoppenfeld contended, on the other hand, that there had been no material omission; that Sperry Rand had never terminated the contract; that Sperry Rand had never ceased performing any essential service required by the contract; that the dispute concerned primarily the payment of the debt which, in any event, was disclosed in the offering circular; that Hoppenfeld had been advised by Arthur Young & Company, the auditors, and by Blair & Company and Nixon, Mudge, Rose, Guthrie, Alexander & Mitchell,* Blair's counsel, that suits brought by the issuing corporations—as distinguished from suits against it—were not material and, therefore, were not required to be noted in the offering circular.

Hoppenfeld discussed the dispute and the lawsuit fully with both Sanders of Blair & Company and Johnston of Arthur Young & Company during the month of February, 1965, and, at a due dilegence meeting in Hoppenfeld's office on or before February 23, called by Johnston who described it as a final meeting of all parties prior to the issuance and underwriting at which all recent events were to be disclosed, Hoppenfeld showed Johnston all of the Sperry Rand correspondence, (Tr. 120-121, 160-161, 178-182, 234-236, 238-241, 244-246, 309-310, 336, 360-363, 896-897, 919-920, 965-966; 53a-55a, 77a, 80a-85a, 103a-110a, 113a-115a, 126a-128a, 143a-144a, 161a-163a, 360a-362a, 383a-384a).

Sanders of Blair & Company was not present, but Johnston, who had been doing investigation for Blair & Company all along and who had been having conferences with Bailey of Nixon Mudge, counsel to Blair & Company, in regard to the audit and investigation of L.R.S., advised Hoppenfeld that he was representing both Blair & Com-

* Hereinafter referred to as Nixon Mudge.

pany and Arthur Young & Company at the meeting (Tr. 178-182, 247, 307-308, 317-319, 324-326, 352-353, 360-365, 955-959, 1044, 1057; 80a-85a, 116a, 124a-126a, 133a-134a, 139a-142a, 155a-157a, 161a-164a, 375a-380a, 423a-424a, 431a).

Hoppenfeld discussed the question of whether mention of the lawsuit against Sperry Rand should be made in the offering circular with both Johnston and Sanders as well as with Bailey and he was advised by all of them that only suits *against* the issuing company were material and required to be disclosed in an offering circular and that his suit against Sperry Rand, in view of the fact that L.R.S. was the plaintiff rather than the defendant, was not a material fact and did not have to be noted in the offering circular (Tr. 241, 336-339, 342-345, 474, 965-966; 110a, 143a-147a, 149a-153a, 383a-384a).

Hoppenfeld, an attorney who had had no experience in the area of securities transactions or regulation, had relied on the expertise of Blair, Nixon Mudge, and Arthur Young & Co.; and L.R.S. and Hoppenfeld had at all times acted in good faith.

Moreover, defendants contended that many of the plaintiffs, including Morton Globus, had made a profit rather than suffered a loss as the result of their transactions in L.R.S. stock.

The jury returned verdicts in favor of the defendants in the cause of action for common law fraud and in favor of each of the plaintiffs in the causes of action based upon statutory violation.

The jury also returned verdicts for punitive damages against each of the defendants in the amount of $1,000 for each plaintiff and, upon being sent out again to reconsider the verdicts and add legal fees, the jury returned even larger verdicts for punitive damages despite the fact that no evidence whatsoever had been adduced by the plaintiffs in regard to the type, value or cost of legal services rendered to them.

1. Argument

The issue in the present case is uniquely narrow and no amount of strained semantics can convert it into one warranting review by this Court on certiorari. Of all the sections of the Securities Act of 1933 and the Securities Exchange Act of 1934 we are here concerned only with one of them, the Securities Act of 1933, and whether punitive damages are available as a remedy for violation of §17 (a) of the Securities Act of 1933, 15 USC Section 77q (a) 1964 (A-35).* The Court of Appeals decision on this issue was manifestly correct. The Court of Appeals in discussing the issue of punitive damages clearly sets forth in its decision (A-35) that if it was the intent of Congress to have included punitive damages as a remedy under §17 (a) then Congress would have found no difficulty in using language appropriate to that end (A-35). As the Court of Appeals indicated, §17 (a) was to serve only as a basis for criminal or injunctive action (A-35).

There is no important question of Federal law requiring decision by this Court. The decision of the Court of Appeals on the issue of punitive damages is clear and concise not only as to the issue that punitive damages have no application in §17 (a) of the Act, but additionally the Court discussed in detail the basis for its ruling that punitive damages are not recoverable under §17 (a) of the Securities Act of 1933.

Although the issue of punitive damages has been discussed by many brief writers and students of the law, there is no evidence to support the contentions made by the petitioner in his brief of the "Plethora of Security Acts law suits now abounding", which petitioner claims require a determination by the Supreme Court.

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* "A" and number designate page in the appendix to petitioner's petition for certiorari.

Contrary to the petitioner's assertion that the Supreme Court should determine conflicting decisions in lower courts, the Court of Appeals in its well reasoned and detailed opinion has determined the applicable law and has clarified the law applicable to punitive damages under the 1933 Act (A-39). It characterized its statement in *Green* v. *Wolf Corp., infra,* as dicta which did not affect the consistency between its two holdings.

The petitioner requests a review of the principles set down in *Green* v. *Wolf Corp.*, 406 F. 2d 291 (2d Cir. 1968), cert. denied, 395 U. S. 977 (1969), denying punitive damages under the 1934 Act even though he conceded that he neither disagreed with the ruling by the District Court on that issue nor raised that issue in the appeal before the Court of Appeals.

The request at this late date that this court review the issue of punitive damages under the Securities Act of 1934 is an indication of the weakness of petitioner's petition for review of the 1933 Act as well as of the 1934 Act.

Interestingly, the Court of Appeals in the decision that is the subject of the petition, supported its finding on the 1934 Act clearly and concisely, setting forth the reason for its holding (A-35), as well as setting forth that its finding in this case is not in conflict in any way with its opinion in *Green* v. *Wolf, supra.*

2. The Court of Appeals' decision does not ignore and is not in conflict with the teachings of the decisions of this Court.

The petitioner alleges that the Court of Appeals has ignored the teachings of the Supreme Court in *J. I. Case Co.* v. *Borak,* 377 U. S. 426 (1964). He concedes that *J. I. Case Co.* v. *Borak, supra,* involves the 1934 Act and goes on to indicate those areas in which he alleges the Court of Appeals has ignored the teachings of this Court which are:

> "The protection of investors," . . . and with reference to activities of the Federal courts that they should . . . "adjust their remedies so as to grant the necessary relief. . . ."

Quite to the contrary, the Court of Appeals has followed the teaching of the Supreme Court in the aforesaid case when they inferred that there should be no discrimination between one group of investors and another, but should encompass all investors equally (A-38).

Following the teachings of this Court, the Court of Appeals found that "smart money" as a result of punitive damages could provide a windfall to the initial litigant to the detriment and injury of all other investors (A-39).

At page 8 of the brief, petitioner erroneously alleges that the Court of Appeals has failed to follow the teachings of the Supreme Court in *Deckert* v. *Independence Shares Corp.*, 311 U. S. 282 (1940).

The specific language which the petitioner alludes to is as follows:

> "The power to make the right of recovery effective implies the power to utilize any of the procedures or actions normally available to the litigant according to the exigencies of the particular case."

The petitioner argues that an action for punitive damages is normally available to the litigant in an appropriate case, and therefor the Court of Appeals has failed to follow the teachings of the Supreme Court. In fact, the Court of Appeals has followed the teachings of the Supreme Court in the *Deckert* v. *Independence Shares Corp.*, *supra*, and has specifically indicated that fact in its decision and has stated contrary to the statements of the

petitioner in holding that ordinarily punitive damages are *not* awarded in situations where there is more than one injured party (A-38).

Finally, the petitioner on page 8 alleges that the Court of Appeals ignored the teaching of this Court in *S. E. C.* v. *Capital Gains Research Bureau, Inc.*, 375 U. S. 180 (1963), when it allegedly failed to follow the Court's direction in interpreting the intent of Congress with reference to the Securities Legislation to:

> "Not technically and restrictively but flexibly to effectuate its remedial purpose."

Again, petitioner is in error, the Court of Appeals has followed the teachings of the Supreme Court in determining that punitive damages or "smart money" (A-38) would not actually serve the remedial purpose against an otherwise honest issuer who egregiously erred in one instance. There can be no question that a remedy that will punish innocent purchasers, i.e., the stockholders of the issuer who are not parties to the litigation, clearly does not serve a remedial purpose and will not effectuate the teachings of *S. E. C.* v. *Capital Gains Research Bureau, Inc., supra.*

3. The Court of Appeals' decision creates no uncertainties.

Contrary to the facts petitioner erroneously argues that the Court of Appeals' decision has created uncertainties as to whether or not punitive damages are allowable under §17(a) of the 1933 Act.

The language of the Court of Appeals in this area is specific and concise. It has stated unequivocally that:

> "We have found that §17(a) of the 1933 Act does not support punitive damages for several reasons" (A-39).

In further clarification of the finding above quoted, the Court states in footnote 10 to A-39:

> *"The interests of justice are clearly served by announcing the rule we consider applicable for all cases under this section"* (italics ours).

The petitioner at page 9 of his brief indicates that the Court of Appeals alleges uncertainties by reason of the alleged contradictory statement in *Green* v. *Wolf, supra.* The Court of Appeals themselves have clarified this issue at page A-40 and have stated unequivocally that *Green* v. *Wolf, supra,* is completely consistent with the holding in the case herein when the Court stated on page A-40 fn. 12:

> "[12] Our opinion in *Green* v. *Wolf Corp., supra,* does contain some language indicating such a dichotomy does exist and that punitive damages may be permissible under the 1933 Act. 406 F. 2d at 303. However it is obvious to the careful reader that this was merely dicta intended to limit the holding in *Green* to the specific issue then before the court, i.e. the validity of punitive damages in an action based on §10(b) and Rule 10b-5 of the 1934 Act and not as approval for the award of punitive damages under the 1933 Act. As we have demonstrated, *supra,* the reasoning of *Green* is completely consistent with our holding here. As to the legislative history on which Judge Mansfield purported to base the discrepancy between the two acts, see 54 Va. L. Rev. 1560 (1968)."

In addition, petitioner is attempting to raise in this Writ of Certiorari a request for review of the holdings in *Green* v. *Wolf, supra.* This is contrary to the teaching of this Court in *Sherman* v. *U. S.*, N. Y. (1958), 78 S. Ct. 819, 356 U. S. 369, 2 L. Ed. 2d 848, which held that the United States Supreme Court does not ordinarily decide issues

not presented by the parties. See also *Lawn* v. *U. S.*, N. Y. (1958), 78 S. Ct. 311, 355 U. S. 339, 2 L. Ed. 2d 321, rehearing denied 78 S. Ct. 529, 355 U. S. 967, 2 L. Ed. 2d 542; *Sonzinsky* v. *U. S.*, Ill. (1937), 57 S. Ct. 554, 300 U. S. 506, 81 L. Ed. 772.

The petitioner concedes and the Court of Appeals states that there is an "arsenal of weapons" available under the Securities Acts, including express criminal, injunctive and administrative remedies. The Court of Appeals very properly found that it is not inherently necessary or desirable to include in the arsenal the extraordinary and little used sanction of punitive damages.

In the case at bar, the Securities and Exchange Commission itself conducted a complete examination and investigation of all the facts and of the individuals involved, within three weeks after the alleged misrepresentations were made in the offering circular, and with all the remedies at its command, the S. E. C. found that the post-distribution letter to be sent to stockholders was all that was warranted under the circumstances.

This is a fair indication and lends substance to the contentions of the Court of Appeals when it voices its fears of the "overkill danger" of punitive damages (A-39 fn. 10).

CONCLUSION

It is, therefore, respectfully submitted that the petition for writ of certiorari should be denied.

Respectfully submitted,

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